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RUEHRL/AMEMBASSY BERLIN 0591
RUEHBY/AMEMBASSY CANBERRA 0613
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RUEHMO/AMEMBASSY MOSCOW 0736
RUEHOT/AMEMBASSY OTTAWA 0566
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SIPDIS

DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR TRINA RAND
USTR FOR COLEMAN
STATE PLEASE PASS USAID
STATE PLEASE PASS USGS
DOE FOR T.SPERL, G.PERSON, A.BIENAWSKI, M.SCOTT,
L.PARKER

SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD EMIN EPET ENRG BEXP
KTDB, SENV, PGOV, SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER
FEBRUARY 8, 2008 ISSUE

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¶1. (U) Summary. This is Volume 8, issue 6 of U.S.
Embassy Pretoria's South Africa Economic News Weekly
Newsletter.

Topics of this week's newsletter are:
- Sector Focus: Auto Industry
- Car Sales Hammered By Rising Inflation, Interest
  Rates and Debt
- New Subsidy Program for Auto Producers
- GM Expands SA Presence
- Ford Increases Investment and Localization
- Renault to Invest in New Plant
- SA to Import Chinese Vehicles
- Power Crisis Leads to Executive Shakeup
- Infrastructure Problems Affect Production
- Coega Aluminum Project Cast in Doubt
- Power Cuts Put Rand on Rocky Road
- Business Confidence Falls to Four-Year Low
- SADC to Boost Air Transport
- Vodacom Offers Free Upgraded Internet
- DEAT Bans Abalone Diving
End Summary.

Sector Focus: Auto Industry

¶2. (U) The South African auto sector makes up about
10% of manufacturing exports. In 2006, the industry's
capital expenditure reached a record R6.2 billion
($800 million). Overall passenger vehicle sales rose,

while import sales exceeded locally-produced vehicle sales for the first time in 2007. As a result, analysts expect the 2007 auto industry trade deficit to remain at 2006 levels, at around R33 billion ($4.2 billion). A number of manufacturers are increasing investments and focusing on exports for 2008. The government is offering new incentives to boost production and exports to decrease the auto trade deficit.

Car Sales Hammered By Rising Inflation, Interest Rates and Debt
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¶3. (U) According to the National Association of Automobile Manufacturers of South Africa (NAAMSA), new vehicle sales decreased from 52,212 units in January 2007 to 47,296 units in January 2008, a drop of 4,916 units, or 9.4% y/y. Passenger car sales increased by 14.6% y/y to 30,483 units in January 2008, while medium and heavy commercial vehicle categories remained strong, rising 27% and 14% y/y, respectively, supported by strong infrastructure spending. Nedbank Chief Economist Dennis Dykes said, "The latest vehicle sales figures show that household confidence continues to fade as the pressure of higher inflation, higher interest rates and higher debt burdens continues to build. Household spending is expected to slow as the year progresses." Since June 2006 the Reserve Bank has hiked interest rates four percentage points to curb inflation fuelled by rising food and fuel prices. The passage of the National Credit Act in - 2007 also made it more difficult for marginal borrowers to obtain credit. (Business Day, February 5, 2008)

New Subsidy Program for Auto Producers

¶4. (U) The South African Government's goal for the local auto industry is to produce 1.2 million vehicles a year by 2020. This target is taking center stage in the drafting of a new policy to replace the current export-based Motor Industry Development Program (MIDP). A new program is likely to subsidize vehicle manufacturers, which achieve annual production of 50,000 units or more per vehicle platform. Vehicle production decreased significantly in 2007, but is expected to pick up in 2008. The industry manufactured around 535,000 vehicles for local and export markets in 2007, down 8.9% y/y from the 587,000 units produced in 2006. The projected production figure for 2008 is 619,600 vehicles. National Association of Automobile Manufacturers of South Africa Executive Manager Norman Lamprecht said 2007 local production most likely took a knock on the back of a slowdown in domestic vehicle sales. A drop in export sales also dented vehicle production, with several companies spending 2007 gearing up for new export programs, says Lamprecht. Vehicle exports reached 179,859 units in 2006, but eased to 171,260 in 2007. Lamprecht expects exports to jump 49% y/y to more than 255,000 vehicles in 2008, "especially as the Toyota Corolla and Mercedes-Benz C-Class export programs start peaking". (Engineering News, January 25, 2008)

GM Expands SA Presence

¶5. (U) General Motors South Africa (GMSA) will invest R481 million ($62 million) to upgrade its tooling and

production facilities in 2008. In addition, construction is under way at a new vehicle conversion and distribution center in Aloes, in Mpumalanga. This multimillion rand storage and logistics facility is due to open during the second quarter of 2008. Other plans include the launch of ten new products in 2008 slated to boost market share. This continues the trend set last year, when the company also launched ten new vehicles. GMSA's retailer network, now standing at 152 outlets, invested R812 million ($105 million) over the past few years in upgrading its facilities. A key area for GMSA going forward is the light commercial-vehicle (LCV) market, where it secured an overall share of 23% in 2007, through buoyant sales of the Isuzu KB and Corsa Utility pick-ups. (Engineering News, February 1, 2008)

Ford Increases Investment and Localization

¶6. (U) Ford announced a R1.5 billion ($215 million) expansion program to expand operations for its next generation compact pickup truck and its turbocharged Puma diesel engine. Construction will begin in 2009.
QPuma diesel engine. Construction will begin in 2009.
Ford will begin manufacturing the pick-ups at its Silverton assembly plant in Pretoria in 2010 and the diesel engines at its engine factory in Struandale, in Port Elizabeth in 2011. Ford South Africa CEO Hal

Feder said South Africa was a highly capable and proven export source that could "successfully deliver at the highest level of global competition". The investment is expected to increase annual capacity at the Silverton plant from 60,000 to 110,000 vehicles, with 75% of the pickups destined for export to Europe, the Middle East and the rest of Africa. The Struandale plant will raise annual production for its Puma diesel engine and components to about 180,000 units, with the majority being exported. Ford plans to increase spending on local components from an annual R441 million ($57 million) to R2.9 billion ($0.4 billion) by 2011. Ford currently achieves about 35% local content, which will improve to more than 60% when production begins. Ford has 4,500 employees at the two plants and expects to hire as many as 500 more by 2011. Ford estimates that an additional 4,000 indirect jobs will be created as the domestic auto-parts industry supplies parts for both a greater number of vehicles and a larger percentage of local content. (Business Day, February 1, 2008 and Ford January 30, 2008 Press Release)

Renault to Invest in New Plant

¶7. (U) DTI Officials told Embassy Economic Officers on February 4 that Renault plans to invest in a new, greenfield automobile assembly plant that will take advantage of the same MIDP incentives that were incorporated into the above-mentioned Ford expansion. This will be Renault's first production facility in South Africa and production will be about 100,000 vehicles per year. The main difference between the two investments is that the expanded Ford plant in Silverton will replace five low-volume existing production lines with two high-volume lines, while the Renault plant will introduce a completely new line for the Sandero hatchback in a completely refurbished former Nissan plant in Guateng.

SA to Import Chinese Vehicles

¶8. (U) McCarthy Limited signed a distribution agreement with Chery Automobile Company of China to import Chinese-made cars to South Africa starting April 2008. Chery estimates that sales volume will exceed 5,000 units by the end of 2008. McCarthy Import and Distribution Executive Director Jolyon Nash said, "Details of the models we will market in South Africa are still being finalized." Chery Automobile Chairman Yin Tongyao was "pleased to be a player in a market that will provide a springboard for sales of our products into other African countries". Chery is the fourth-ranked Chinese automobile manufacturer in passenger car production. (Business Day, February 1, 2008)

Power Crisis Leads to Executive Shakeup

QPower Crisis Leads to Executive Shakeup

¶9. (U) Eskom replaced Ehud Matya as head of it's Primary Energy and Power Plant Division in the

aftermath of weeks of crippling power generation problems. On February 4, 2008, Eskom had 3,000 megawatts out of commission due to planned maintenance and 2,388 megawatts unavailable due to unexpected outages. An additional 4,060 megawatts was offline due to load losses resulting from either poor quality coal or wet coal. Maroga said: "We are undoubtedly experiencing one of our most difficult periods in Eskom's recent history, as power supply interruptions reach a level that is unprecedented in South Africa." Brian Dames will now be responsible for primary energy, power plants, and capital investment. According to an Eskom spokesperson, CEO Jacob Maroga wanted the various components of power generation consolidated under one manager. Matya, who remains a company executive, will be responsible for negotiating power buy-back from big industrial users. The management shake-up means that Dames will continue heading up the investment of R300 billion ($39 billion) in new power plants in the next five years, in addition to being responsible for coal sourcing and maintaining 39,200 megawatts of existing capacity. (Business Report, February 5, 2008)

Infrastructure Problems Affect Production

¶10. (U) Steel maker Highveld Steel & Vanadium warned that unannounced municipal water supply and electricity interruptions pose severe challenges to business. It called for the government to prioritize capital investment for electricity, water, and rail infrastructure. In the second half of 2007, production was negatively affected by random electricity and water supply interruptions. The group said load shedding and demand market participation agreements with Eskom resulted in 35 hours of lost production, equivalent to about 2,000 tons of finished rolled steel products. Power Interruptions in January 2008 posed a considerable threat to operations, with 150 hours of lost production, equivalent to about 8,500 tons of lost production. However, the group posted strong results for the year to December 2007, with overall demand for steel and vanadium strong. Net cash generated by operating activities rose 41% to R1.3 billion ($173 million) after demand and prices for steel and vanadium rose. (Business Day, February 7, 2008)

Coega Aluminum Project Cast in Doubt

¶11. (U) Power shortages cast doubts on prospects for Rio Tinto's Coega aluminum smelter project in Port Elizabeth. In November 2006, Eskom signed a 25-year contract to supply 1,350 megawatts of electricity to the smelter by 2014. Eskom has since announced a power deficit to continue until at least mid-2012. Macro analyst Nazmeera Moola criticized the Coega QMacro analyst Nazmeera Moola criticized the Coega project since aluminum smelters use 6.5% of Eskom's total electricity while contributing only 0.1% to gross domestic product. Rio Tinto Chief Executive of Energy and Minerals Preston Chiaro said Rio Tinto would proceed with the Coega project as long as the government and Eskom provided assurances that there

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would be power to supply it. If Eskom could no longer provide power guarantees, then Rio Tinto would have to look at energy alternatives. Rio Tinto took control of the Coega project last year through a $38 billion buyout of Alcan, and has just rejected BHP Billiton's $150 billion buy out offer. BHP Billiton also reported that power constraints had prevented the expansion of its three aluminum smelters in South Africa and Mozambique. (Financial Mail, February 8, 2008 and Business Report, February 7, 2008)

Power Cuts Put Rand on Rocky Road

¶12. (U) Analysts expect economic growth in South Africa to slow from about 5% in 2007 to 3%-4% in 2008, curbed mainly by the effect of frequent power outages on production and higher interest rates on consumer spending. This has added to growing fears of a U.S. recession, which prompted a risk-averting sale of local shares and bonds last month and an initial weakening of the rand. So far this year the volatile unit has depreciated more than 13% against the dollar and more than 11% against a trade-weighted basket of currencies. Traders and analysts said the rand was now on course to slide to R8.25 or R8.30 against the dollar, which will add to upward pressure on inflation, and raise the risk of further interest rate hikes. One of the main problems for the rand is the ballooning South African current account deficit, now at more than 8% of gross domestic product (GDP). With a global economic slowdown curbing demand for exports and an official R482 billion ($63 billion) infrastructure spending plan boosting imports, the shortfall can only continue to widen. If the shortfall is not offset by similar amounts of investment inflows, which in South Africa's case come mainly from portfolio investments in local shares and bonds, the rand has to weaken. This will stoke inflation, which has already breached the upper end of the 3%-6% official target range for consecutive nine months, reaching 8.6% in December 2007. JPMorgan urged investors to trim holdings of South African shares, citing electricity shortages, political uncertainty and a potential U.S. recession. "We are concerned that South African-specific risks have escalated ... the electricity crisis has shaken our confidence in South Africa's growth outlook." (Business Day, February 8, 2008)

Business Confidence Falls to Four-Year Low

¶13. (U) The South African Chamber of Commerce and

Industry (SACCI) business confidence index (BCI) dropped from 94.8 points in December 2007 to 93.8 points in January 2008. SACCI said that apart from a single instance in April, when the BCI jumped to 101.9
Qsingle instance in April, when the BCI jumped to 101.9
points, the index had been in a declining trend throughout 2007. This is the lowest January level since 2003, when the BCI stood at 82.8 points, and the lowest overall level since October 2003, when it stood at 91.6 points. According to the SACCI, the negative business sentiment was due to declining international trade volumes, a weaker rand, rising inflation and a

falling stock exchange. However, the negative sentiment was partially offset by record precious metal prices, slightly positive data on retail and vehicle sales and lower real financing costs. (Business Day, February 6, 2008)

SADC to Boost Air Transport

¶14. (U) The Southern African Development Community (SADC) prioritized air transport as a measure for delivering a quality 2010 FIFA World Cup and the 2009 FIFA Confederations Cup. A joint meeting of SADC, Common Market for Eastern and Southern Africa (COMESA) and the East African Community (EAC) Civil Aviation Directors and industry executives highlighted a need for interventions and improvements. The officials identified a shortage of human resources such as pilots and navigation agencies as challenges in the Victoria Falls region. The meeting cited the airline industry's ability to meet ever-increasing demand as another challenge facing SADC. Delegates stressed the need to provide efficient, cost effective, and affordable air transport service, with emphasis on the introduction of direct city-to-city flights. They resolved to establish working groups, tasked with developing and implementing government interventions such as a fast-track Open Skies Policy. Representatives of the International Civil Aviation Organization, Airline Association of Southern Africa, and the International Air Transport Association were also present. (Engineering News, February 4, 2008)

Vodacom Offers Free Upgraded Internet

¶15. (U) Vodacom is driving mobile-data connections with its latest move to offer a free upgraded high-speed internet service to existing subscribers for three months. Vodacom's move follows that of rival MTN, which announced last week that it would offer higher-speed data at selected metropolitan locations at no extra charge. Vodacom said this move would allow customers to access the fastest mobile broadband connection and attract new data customers. Customers who have devices, such as the Vodafone Mobile Connect USB Modem, will be able to add the new service, a high-speed downlink packet access (HSDPA) of 3.6 megabits per second, to existing data packages. HSDPA is a third-generation, mobile-telephony protocol which offers increased data transfer speeds and capacity. (Business Report, January 30, 2008)

DEAT Bans Abalone Diving

¶16. (U) The Department of Environmental Affairs and Tourism (DEAT) announced new regulations restricting abalone diving on February 1, 2008. DEAT Minister

Marthinus Van Shalkwyk said the ban is an essential
component of DEAT's strategy to protect abalone in key
Qcomponent of DEAT's strategy to protect abalone in key
areas where the stocks have a potential to recover
from serious depletion. The ban will be imposed in
five areas including Robben, Dyer and Bird Islands, as

well as Cape Point and the coastal area between
Gansbaai and Quon Point. The ban was met with strong
objections from local fishermen. South Africa reduced
abalone harvest quotas from 3,000 tons in 1965 to 125
tons in 2007. However, stock depletion continued due
to illegal harvesting. (Business Day, February 4,
2008 and DEAT Media Statement)

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